

dividend only if received from sources within the United States, the amount specified in the consent of the shareholder shall be treated as a dividend from sources within the United States in the same manner as if the dividend has been paid in money to the shareholder on the last day of the corporation's taxable year. See paragraph (b) of this section relating to the making and filing of consents, and section 565(e) and § 1.565-5, with respect to the payment requirement in the case of nonresident aliens and foreign corporations.

(2) To the extent that the Commissioner determines that the corporation making a consent dividend is not a corporation described in paragraph (a) of this section, the amount specified in the consent is not a consent dividend and the amount specified in the consent will not be included in the gross income of the shareholder. In addition, where a corporation is described in paragraph (a)(1) but not paragraph (a)(2) of this section, to the extent that the Commissioner determines that the amount specified in a consent is larger than the amount of earnings subject to the accumulated earnings tax imposed by part I of subchapter G, such excess is not a consent dividend under paragraph (a) of this section and will not be included in the gross income of the shareholder.

(3) Except as provided in section 565(b), § 1.565-2 and paragraph (c)(2) of this section, once a shareholder's consent is filed, the full amount specified in such consent must be included in the shareholder's gross income as a taxable dividend, and the ground upon which a deduction for consent dividends is denied the corporation does not affect the taxability of a shareholder whose consent has been filed for the amount specified in the consent. For example, although described in part I, II, or III of subchapter G, or part I or II of subchapter M, chapter 1 of the Code, the corporation's taxable income (as adjusted under section 535(b), 545(b), 556(b), 852(b)(2), or 857(b)(2), as appropriate) may be less than the total of the consent dividends.

(4) A shareholder who is a nonresident alien or a foreign corporation is taxable on the full amount of the

consent dividend that otherwise qualifies under this section even though that payment has not been made as required by section 565(e) and § 1.565-5.

(5) Income of a foreign corporation is not subject to the tax on accumulated earnings under part I of subchapter G, chapter 1 of the Code except to the extent of U.S. source income, adjusted as permitted under section 535. See section 535 (b) and (d) and § 1.535-1(b). Therefore, foreign source earnings (other than those distributions subject to resourcing under section 535(d)) of a foreign corporation that is not described in paragraph (a)(2) of this section cannot qualify for consent dividend treatment. Accordingly, a consent dividend made by a foreign corporation described in paragraph (a)(1) of this section shall not be effective with respect to all of the corporation's earnings, but shall relate solely to earnings which would have been, in the absence of the consent dividend, subject to the accumulated earnings tax.

[T.D. 8244, 54 FR 10538, Mar. 14, 1989]

§ 1.565-2 Limitations.

(a) *General rule.* Amounts specified in consents filed by shareholders or other beneficial owners of a corporation described in § 1.565-1(a) are not treated as consent dividends to the extent that—

(1) They would constitute a preferential dividend or

(2) They would not constitute a dividend (as defined in section 316),

if distributed in money to shareholders on the last day of the taxable year of the corporation. If any portion of any amount specified in a consent filed by a shareholder of a corporation described in the preceding sentence is not treated as a consent dividend under section 565(b) and this section, it is disregarded for all tax purposes. For example, it is not taxable to the consenting shareholder, and paragraph (c) of § 1.565-1 is not applicable to this portion of the amount specified in the consent.

(b) *Preferential Distribution.* (1) A preferential distribution is an actual distribution, or a consent distribution, or a combination of the two, which involves a preference to one or more shares of stock as compared with other

shares of the same class or to one class of stock as compared with any other class of stock. See section 562(c) and § 1.562-2.

(2) The application of section 565 (b) (1) and § 1.565-2 (b) may be illustrated by the following examples:

Example 1. The X Corporation, a personal holding company, which makes its income tax returns on the calendar year basis, has 200 shares of stock outstanding, owned by A and B in equal amounts. On December 15, 1987, the corporation distributes \$600 to B and \$100 to A. As a part of the same distribution, A executes a consent to include \$500 in his gross income as a taxable dividend although such amount is not distributed to him. The X Corporation, assuming the other requirements of section 565 have been complied with, is entitled to a consent dividends deduction of \$500. Although the consent dividend is deemed to have been paid on December 31, 1987, the last day of the taxable year of the corporation, the total amount of all distributions constitutes a single nonpreferential distribution of \$1200.

Example 2. The Y corporation, a personal holding company, which makes its income tax returns on the calendar year basis, has one class of consent stock outstanding, owned in equal amounts by A, B, and C. If A and B each receive a distribution in cash of \$5,000 and C consents to include \$3,000 in gross income as a taxable dividend, the combined actual and consent distribution of \$13,000 is preferential. See section 562 (c) and § 1.562-2 (a). Similarly, if no one receives a distribution in cash, but A and B each consents to include \$5,000 as a taxable dividend in gross income and C agrees to include only \$3,000, the entire consent distribution is preferential.

Example 3. The Z Corporation, which makes its income tax returns on the calendar year basis and is subject, for the taxable year in question, to the accumulated earnings tax, has only two classes of stock outstanding, each class being consent stock and consisting of 500 shares. Class A, with a par value of \$40 per share, is entitled to two-thirds of any distribution of earnings and profits. Class B, with a par value of \$20 per share, is entitled to one-third of any distribution of earnings and profits. On December 15, 1987, there is distributed on the class B stock \$2 per share, or \$1,000, and shareholders of the class A stock consent to include in gross income amounts equal to \$2 per share, or \$1,000. The entire distribution of \$2,000 is preferential, inasmuch as the class B stock has received more than its pro rata share of the combined amounts of the actual distributions and the consent distributions.

(c) *Section 316 Limitation.* (1) An additional limitation under section 565 (b) is that the amounts specified in consents which may be treated as consent dividends cannot exceed the amounts which would constitute a dividend (as defined in section 316) if the corporation had distributed the total specified amounts in money to shareholders on the last day of the taxable year of the corporation. If only a portion of such total would constitute a dividend, then only a corresponding portion of each specified amount is treated as a consent dividend.

(2) The application of section 565 (b) (2) and § 1.565-2 (c) may be illustrated by the following example:

Example. The X Corporation, a corporation described in § 1.565-(a) (1) or (2), which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned in equal amounts by A and B. It makes no distributions during the taxable year 1987. Its earnings and profits for the calendar year 1987 amount to \$8,000, there being at the beginning of such year no accumulated earnings or profits. A and B execute proper consents to include \$5,000 each in their gross income as a dividend received by them on December 31, 1987. The sum of the amounts specified in the consents executed by A and B is \$10,000, but if \$10,000 had actually been distributed by the X corporation on December 31, 1987, only \$8,000 would have constituted a dividend under section 316 (a). The amount which could be considered as consent dividends in computing the dividends paid deduction for purposes of the accumulated earnings tax is limited to \$8,000, or \$4,000 of the \$5,000 specified in each consent. The remaining \$1,000 in each consent is disregarded for all tax purposes. (In the case of a personal holding company, see also the example in § 1.565-3(b).)

[T.D. 8244, 54 FR 10539, Mar. 14, 1989]

§ 1.565-3 Effect of consent.

(a) *General Rule.* The amount of the consent dividend that is described in paragraph (a) of § 1.565-1 shall be considered, for all purposes of the Code, as if it were distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation, received by the shareholder on such day, and immediately contributed by the shareholder as paid-in capital to the corporation on such day. Thus, the amount of the consent dividend will be treated by the shareholder